Financing as the Manager Sees It

By Howard Coonley,
President, Walworth Manufacting Company, Boston, Mass.

IT is not unfair, I believe, to say of the average manager of a business, that he gives in the early stages of his undertaking less thought to his finances than to any of the major problems which he has to solve. Yet the financial policy is second in importance only to his handling of the industrial relationship questions. The latter stand out in bold relief before him, and he will find in the end that the same principles govern his financing as regulate his methods of production and problems of personnel.

The last few years fortunately have shown industrial managers that a veil of secrecy drawn over their operations is not an asset but a liability. The man who is ever ready to show to his fellow industrialist—whether or not he be a competitor—his product, his equipment and his balance sheet, is the one who receives the greatest respect and the largest return benefits. In financing, as in every other branch of management, the principles of the open book and the square deal point the only sound road to success. They are the great indicators and if the executive follows them with a clear brain, red-blooded courage and such conservatism as "horse sense" dictates, he will not be apt to go astray.

There are innumerable ways of working out these broad basic principles. It seems to be a truism that in starting a new business, as in building a new house, it is against all rules to provide enough money in advance. As a matter of fact, nine times out of ten no financial policy is laid down until the executive has encountered serious difficulties and is therefore forced to develop a plan. His problem then is identical with that faced by the manager who comes into an old and once prosperous business which has slipped into the doldrums. Each must now laboriously pick his way through the tangled and slippery path, which if approached earlier would have been simple. He is wise indeed who adopts a policy before he finds himself forced to work one out.

The only foundation upon which a sound policy can be built is that of "financial morality." By this I mean much more than clean hands in the handling of finances. It calls for absolute scrupulousness in every statement made. It is even more necessary to be entirely accurate when things are going wrong than when they are going right. Frankness always inspires confidence, and the confidence of every individual or group of individuals interested in your business is essential. Without such confidence there can be no hope of full development and complete success.

Naturally the first group to be kept in intimate touch with your situation is your directors, the next your stockholders, the third your bankers, the fourth your employes and the last, but by no means least, the public. Few business men realize what material help can be gained through being advised in all important steps by their bankers. Here is a group of specialists, highly trained in their profession, with every reason to assist where it is possible, and who are always in a position to bring in an outside, yet interested view point; and yet how seldom is this talent utilized. To go to the banker only when you have something good to tell him is the height of folly. Then you do not need his services. But when your mind is disturbed and you have situations to meet where you need a cool head, then you can find close at hand an able adviser who is always looking out for your best interests, because they run parallel to his own.

Even should your banker not be able to give you valuable advice, it would still be wise to follow this policy for the sole purpose of gaining his confidence. When he learns the difficulties you encounter and has evidence of your ability to solve them, his confidence will be won, and confidence is the strongest possible foundation for credit. For some unknown reason many executives look upon a banker with distinct awe which sometimes amounts almost to fear. They enter the portals of his office with a feeling of embarrassment and in consequence state their case timidly and therefore unconvincingly. Such an attitude is, of course, ill founded and unfortunate. The experienced banker knows the fluctuations of an ordinary business and is naturally ready and anxious to discuss yours with you. Remember that it is through the loans he makes to you, as well as the deposits he receives from you, that his own business is built up.

There was once a struggling young firm of brothers in the Middle West. They had made a start on inherited money and progressed well up to a point where, to meet a most promising trade opening, they faced the necessity of making extensive improvements and additions to their plant. The firm was sound. It had a small but efficient plant and was manufacturing a ready-selling product in a market that brought good, steady returns. But the brothers had sunk nearly all their money into the plant and had far too little left for working capital.

Because their business was in the town where they had been reared and they were looked upon as the town's "élite," the young men felt a sense of embarrassment about money matters and made the mistake of surrounding their financial affairs with secrecy. They felt that to make known matters involving their company's capital might operate against their prestige, particularly because of their intimacy with the townspeople and their consequent fear of gossip and criticism.

Their banker knew little about the brothers' business beyond the fact that in a period of general prosperity, their balance had been almost depleted by large withdrawals. He did not know that the young firm had invested heavily in improvements with the prospect of large returns. The boys had good business judgment and their investment at this time was wise. But they had miscalculated costs and suddenly found themselves without funds to buy necessary supplies and to meet their immediate payrolls. Fortunately for them their banker was wiser than they knew. Rumors had reached him of a financial crisis at the plant and he did not wait for the crash. He went to the brothers and after some prodding, drew from them the true story of their plight. The young manufacturers found that they could get all the money they needed from their bank, because their policies and prospects were sound. Their foolish policy of secrecy had brought them to the verge of nervous breakdown, and might under other circumstances have caused their failure. After that, these two brothers went to the wise banker with every financial problem and laid their cards face up on the table. Today success is theirs. They got from the banker not only needed funds but the sound advice of seasoned judgment.

This story also leads us to another fundamental of financing.

I refer to the borrowing of money. A business which is undergoing a healthy growth should through temporary periods employ outside funds. If it does not it is not availing itself to the full of its own capital. It is, therefore, essential to establish and maintain credit with the bankers. Use must be made of credit in order to maintain it. Every bank likes to do business with the company that borrows funds, but by the same token it expects such borrowings to be cleaned up at least once a year. I know of a case where a certain company borrowed funds year after year even though they did not need them, simply to establish credit. Some years later when they found it possible to use temporarily much more money than they had in the bank, it was easy for them to borrow what they needed. Had they, however, gone through a long period of years without borrowing, their bankers would have questioned their reasons for going into the market and might even have been suspicious of their financial soundness.

The wise manager will establish a line of credit with his bankers at least double that which he expects to use. I say bankers, because in most cases it is wise to have more than one banking connection. He will then see to it that his balances fully warrant the line of credit which he asks and will also provide that at least once a year his loans are entirely cleaned up. At the same time he will keep his banker in touch with the amount of his borrowings and will let him know why he needs the money and how he intends to take care of the payment. He should also periodically use his entire line in each bank. This insures the privilege of the full line at any time it may be required, and also provides a valuable instrument for increasing the line later on if that is necessary.

A broad gauged banker studies the balance sheet with two points in mind, first the firm's present condition as shown by the comparison of his quick assets and quick liabilities, and second the progress indicated by the study of previous showings. It is not always the firm that is out of debt which is sought as the best credit risk. It is the one that has able and thoroughly honest management, a good product and a record of rapid but sound growth, which is sought. It is, therefore, essential in laying out a financial policy to keep these points in view.

Another cardinal principle of sound financing is to have at least one period in each year in which the business is liquidated.

Other things being equal, it is advisable to carry out this liquidation at the end of the calendar year, assuming that this is also the end of the fiscal year, because by this process it is possible to make a better statement to all those interested in the company. In many businesses, however, a liquidation at that time is impossible because of the seasonability of the product. In such industries as the agricultural implement, the period of high production and shipment extends through the winter and well into the spring, and it would be unwise in such a case for them to cut down their inventory at the period of maximum production. To a large extent, therefore, producers of agricultural implements have made the end of their fiscal year somewhere about the end of May and have used this also as their period of liquidation. The value of such a "clean-up period" is not only that of a good financial statement; it also provides the best possible opportunity of a general checking up throughout all the activities of an organization.

An intensive effort of this kind throws a spotlight on every branch of the organization. Delays and weaknesses in production, shipment, collection, etc., are brought to the front and an opportunity is given to correct soft spots in the organization. An executive who does not follow this method loses the best weapon he has for increasing his efficiency.

Many people consider that a long period of high dividends is the best indication that can be made of a corporation's prosperity. This is far from being the case. In an effort to bring about good returns for the stockholders, a great majority of executives bleed their businesses to such an extent that they are not left with sufficient capital to invest in improved machinery and modern tools. Then when they come into a season of low demand with the inevitable struggle on each corporation's part to maintain its share of business, they find it impossible to meet the prices of a thoroughly modern producer without incurring a loss and are in consequence often thrown into a position of great financial embarrassment.

One of the first lessons I was taught was that a business which paid out to its stockholders annually more than one-half of its profits was sure to run down hill. With a constant call for the expansion in every line of production requiring new patterns, new machines and additional stock, together with the necessity of increasing the investment in quick assets as the business grows, a

policy of constant addition to the company's surplus is the only safe one to pursue. Over a period of years the business which does not show a profit of 15 per cent on its capital invested, is not a healthy one, because such a profit will not warrant a dividend greater than 7 per cent. And the holder of common stock who is not receiving a dividend of 7 per cent or a steady increase in the asset value of his stock, will be much better off by taking his money out of this business and placing it in bonds or securities which pay a slightly lower return, but which would be much safer under liquidation.

I have spoken in the earlier part of this article about the necessity of entire frankness not only to our directors, stockholders and bankers, but also to our workmen and the public at large. The last few years have taught us many lessons, but none so important as the necessity of a close relationship between employes and management. The war has brought about a new era in industrial relationships, one which when followed out to the end will lead to some form of industrial partnership that will give the workmen an opportunity to share in the profits, and through such sharing his interest will be aroused in the greater efficiency of production and will automatically bring to capital a greater return than it has had heretofore.

Almost all wide awake executives have created within their plants joint committees of employes and management who are gradually taking over the decisions in matters which concern the workers. Through such a medium a great amount of information can be spread to all the employes regarding the actual facts about the business. I am one of many who believe that publicity is the best remedy for any dissatisfaction. In conferring with one of our plant committees a short time ago I was much interested to learn that the workers had an idea that the item of surplus on our balance sheet indicated money in the bank which, at some time when the world at large was not looking, could be distributed among the stockholders. I took occasion to give a very full explanation of the surplus account, how it grew, why it was necessary and why it was absolutely impossible to distribute it. The effect on the men was very wholesome. It gave them a new view point as to the profits of the company and answered many of the questions over which they had been brooding. It is

misconceptions of this kind that breed a cancerous growth in our industrial communities and lead to misunderstandings and troubles that should never exist. In the same way, that tremendous force, Public Opinion, can be moulded through the principles of frankness and fair dealing and the good will in industry built up which is almost impregnable.